INTERNATIONAL HELLENIC UNIVERSITY

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Coursework Cover Form

Alban Mehmeti / ID 1101100019	**Business Consultancy Project:**
Subject: Corporate Governance	

CORPORATE GOVERNANCE

AND

THE BOARD OF DIRECTORS IN BANKING INDUSTRY

(A SURVEY ON THE BANKING SYSTEM IN ALBANIA)

Supervisor: Georges Selim	**Submission Date: 31.01.2013**

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Abstract

“The job of the board is all to do with creating momentum, movement, improvement and direction. If the board is not taking the company purposefully into the future, who is?” (*Sir John Harvey Jones)*

With globalization vastly increasing the scale of trade and the size and complexity of corporations and the bureaucracies constructed to attempt to control it, the importance of corporate governance and internal regulations has been amplified as it becomes increasingly difficult to regulate externally.

Corporate Governance refers to the processes, structures and information used for directing and overseeing the management of an institution. A good corporate governance framework establishes the mechanisms for achieving accountability between the Board, senior management and shareholders, while protecting the interests of relevant stakeholders. It also sets out the structure through which the division of power in the organization is determined. The role and importance of banks in the financial system and the way banks are funded underscores the need for a framework for corporate governance for licensed banks. The legislative framework for banks recognizes this crucial role and the risk of malfeasance. Our understanding is that by focusing in this direction and being involved directly in this process in our organization, by researching in a methodological way and elaborating in depth on the subject, We may have a direct contribution to the enhancement of the corporate governance structure and practices in our organization as well as an indirect role, through different professional associations to the melioration of the system of governance of financial institutions in general in our country. We trust that this is a historic period for our country aspiring to be integrated soon in the big European Union family.

Chapter 1

Introduction

1.1 Banking System in Albania and Governance scene

The governance system in the Banking sector in Albania has been travelling a long journey of transformation for being aligned with the European Union directives for some years now.

The banking system in Albania is a very recent one. It all started with the collapse of the old socialistic system at the early 90s with the privatization of one of the state owned banks. After that two Greek banks joined the system with their Branches namely Tirana Bank (part of Piraeus Group) and NBG Albania Bank (part of National Bank of Greece). Later on, other banks created their presence in Albania by reaching a total number of 16 Banks, two of them having Albanian shareholders. With all these changes happening, the need for revision of legal and regulatory framework, of which peak was the enactment of the new law on Banks in 2006 and the continuous adaptation of the Bank of Albania's regulations with the best international practices, has been more than evident. During the years 2000 to 2008 there has been a huge credit growth and the Banks experienced high rates of return on equity and on assets. At the time, the number of non-performing loans was at very low levels and there was a growing competition for gaining market share in terms of deposits and loans. With the improvement of banking regulations, banks are paying more attention to their being in line with that regulatory framework, thereby creating specialized functions in their structures in order to meet the changing conditions. In addition, being that major part of banks present in Albania are part of large banking groups (branches and subsidiaries of foreign banks) many of them are adopting the best international practices that go beyond the local legal and regulatory requirements. This forward-looking approach toward the best international practices is also imposed byBank's group policies guided by the European Union guidelines. This whole framework has drawn the attention of the banking community in Albania while applying the international best practices of Corporate Governance. By raising the bar, very good efforts are done towards the direction of improving the corporate governance system even in commercial companies. The enactment of the new law “On Entrepreneurs and Commercial Companies” as well as the Law “On Securities” has been a very good qualitative step to improving the gaps identified even by the OECD 6th South East Europe Corporate Governance Roundtable. Despite the efforts undertaken by the legislator, there is still much work to be done especially in the improving the judiciary system mainly in dealing with the governance issues.

As regards the Banking public sector, it is Bank of Albania in its capacity as supervisory authority which covers the activity of the second tier Banks operating in Albania.

The History of the Bank of Albania and its credit and monetary system in Albania is the history of the attempts preceding the foundation of the National Bank of Albania (1925-1944), the transformation to the State Bank of Albania (1944-1992), to be concluded in 1992 with the Bank of Albania, which enjoys with the attributes of a modern central bank. Albania had its first central bank institution in 1913. This institution did not live long due to the political climate of the era and to the outbreak the First World War. It recommenced its activity in 1925 under the name National Bank of Albania, with the administrative centre located in Durrësi City.

At the end of 1990, the transition of the political system in Albania reflected vital changes, leading the economy to enter into a transforming stage from a state-owned economy in a free market one. This changeover gave life to the two-tier banking system in Albania. Thus, on April 22, 1992, the Bank of Albania was established by the approval of the Law No. 7559, “On the Bank of Albania”, which was reviewed latter in accordance with the models taken from the western countries and the recommendations provided from the international organizations.

The Bank of Albania is a fully state owned bank and is accountable to the People’s Assembly of the Republic of Albania. The Bank of Albania is managed by the Supervisory Council which is composed of 9 members, appointed by the People’s Assembly of the Republic of Albania for a term of seven years, eligible for reappointment.

The Supervisory Council is headed by the Governor, who serves as General Executive Director as well, in charge of the day-to-day business of the Bank of Albania. The Supervisory Council is charged with the supreme direction and supervision of the policies, administration and operations of the Bank of Albania. In carrying out its functions, the Supervisory Council must periodically assess the economic situation, including the monetary, credit and exchange rate policies. Its functions and duties, as well as its composition are set forth in the Law On Bank of Albania. (Bank of Albania web site)

The Bank of Albania, within the competences defined by the Law, is independent of any other power for the accomplishment of its main objective and in exercising the tasks assigned. As part of its mandate to ensure a sound and safe banking system, the Bank of Albania supervises and regulates the activity of banks and institutions of the country that perform banking activity.

1.2 Research Objectives

Corporate governance is often related with boards as a topic which is debated a lot in corporate, association's environments and media across the world. Nevertheless, more intense discussions are national phenomena because of the belief that boards are not to be compared on an international plane. The major parts of the subject writers argue that there is a great deal to be learned from such comparisons because it seems that boards in different countries have more similarities than they have differences.

This project will make a survey in empirical and theoretical level on the mechanisms of corporate governance, focusing, however, on the Board of Directors practices as one of the most important bodies and a key milestone in the corporate governance journey. A comparative analysis will be made to the corporate governance system in the Albanian Banking industry in general and in the organization we work in, in particular. While main efforts are done in reorganizing and improving both above cited systems through legal and regulatory intervention, the final aim is to evaluate and conclude with some real and comprehensive recommendations to improve the actual practices related to the Board of Directors in our organization. The relevant personal experience and the contribution to this process through the professional organizations during the implementation of legal and regulatory changes will be subject of further discussion and elaboration.

1.3 Methodology

The overall design of the project is aimed at answering the main research questions. We perceived the need to design the project that both fits and is obtained from the question, a mixture of mainly qualitative methods, the selected topics, and the research goals. The research design is treated as a problem which is considered carefully at the beginning of this study. However, it was further reconsidered throughout the development of the project as new data and more detailed questions answering the main ones raised. An interview with the representatives of 12 out of 16 Banks in Albania was conducted and the results are shown in Appendix 1.

1.4 Limitations of the Study

Since the methodology used was mainly empirical, (including review of the annual reports published in the web site of Bank of Albania, press releases etc, as well as the relevant interview mentioned here above) we noticed in some cases lack of updated information or non availability of crucial information which in certain cases limited me even further in terms of pointing out and as a consequence in creating an overall view of the governance problems in Albania. In addition, given the rather small size of the banking system in Albania as well as the boundaries set by the law, certain Research Question could not be verified.

1.5 Structure of the Dissertation

As we state above, we shall continue by discussing more extensively (i) the Role of the Board in a banking organization; (ii) the composition of the Board (iii) the board meetings (iv) the directors, the Board independence and the role of the independent directors; (v) Split of Roles between CEO and Chairman of the Board; (vi) the Board performance and how they can be evaluated by providing an emphasis to the importance of the Boards evaluation and the relevant impact in the overall performance of the organization. In addition, the aforementioned topics will be discussed in the framework of the existing literature and most recent practices recommended by international organizations. The comparative analysis we mention here above will be done per each topic discussed. At the end a summary of the conclusions and recommendations related to the governance system will conclude this paper.

Chapter 2
The Role of the Board in a banking organization

2.1 Introduction

The Basel Committee on Banking Supervision calls for the need to study and improve the mechanism of corporate governance of Banks. The Basel Committee on Banking Supervision suggests in particular a structure which is composed of senior management and a board of directors (Enhancing Corporate Governance for Banking Organizations - February 2006). The message the Basel Committee on Banking Supervision launches is the belief that with the implementation of sound corporate governance practices the monitoring efficiency increases. Moreover the Committee's conviction is that good corporate governance can ensure a healthy financial system in the country.

Being complex organizations, banks have a way of diminishing the capacity of shareholders to monitor decision-making process of managers. Banks play an immense role in the payment as well as in the functioning of economic systems of the country. In addition, banks are into the business of making loans, receiving deposits, and processing information, which makes them different in many aspects. For the aforementioned reasons, banks are subject to intense regulation, as long as they safeguard the rights of depositors by reducing systemic risk and guaranteeing the stability of the payment system.
The latest papers on the Boards role mainly base their arguments in the best composition in terms of efficiency by providing in depth analysis on the functions of monitoring and advising (Adams and Ferreira - 2007; Raheja - 2005). According to the complexity and the size of the organization the need of the advisory role is defined. This calls for an increased number of BoD

members. At the same time a persistent governance problem continues to be the need of having an enhanced monitoring function.

Even though the system of corporate governance in banking institutions plays a special role because of the complexity and uniqueness of these entities, the issues related to governance are not so different compared to the ones in other organizations the business of which is related to exchange of goods (Andrés and Vallelado - 2008). Indeed, the main differences between the board composition of banks and non-financial firms refer to their regulation and supervision.

Banks are regulated institutions and this regulatory framework plays a very important role because systems such as payment and economic development are dependable on financial stability of banks. In the banking industry, supervisors and regulators represent one very important stakeholder. Anyhow, their objective may not be in line with the one of other stakeholders (Diamond - 1984). It is more than understandable that the monitoring function of the regulators is one additional external governance mechanism the banks have. However, this mechanism may deteriorate the governance problems. [e.g. regulators may impose restrictions regarding the ownership structure; discourage competition; set restrictions as to the way boards are composed etc. (Prowse -1997; Macey; O'Hara – 2003; Law 9664/2006 "On Banks in the Republic of Albania")]. In addition, regulators might limit the power of markets to discipline the banks (Ciancanelli and Reyes – 2001). Since regulators intervene often in many ways, even in the shareholding structure of financial institutions, we may say that a conflict of interest is generated. This conflict creates doubts as regards the efficacy of supervision system and discourages the shareholder to control managers (La Porta et al. - 2002).

2.2 The Role of the Board of Directors in a Banking Organization

The role of Boards of Directors as one of the key mechanism of corporate governance systems in financial institutions has taken ground in a framework of intense regulation, limited competition, and informational asymmetries caused by the complex nature of banks. In this context, the board becomes a very important tool to monitor managers as well as to advise them on the identification and implementation of strategies (Andrés and Vallelado - 2008). The specialized knowledge of Bank's directors in banking area enables them to duly perform their monitoring advising duty with efficiency.

As banks are organization having a decision system in which the management is separate from the control of decisions, the need for having an effective governance mechanism that can prevent with efficiency the expropriation of resources turns into a must. In this framework, Boards are considered as a major part of the answer to agency problems in organizations.

The impact that the board of banks has on the corporate value is studied to a great extend. Recent research (Andrés and Vallelado -2008; Adams and Mehram - 2008) on banking governance suggests that board composition, activity and size affect the effectiveness of boards as well as the value of the bank. In disagreement with proposal of non financial studies, the size board shows a non-lineal (Andrés and Vallelado -2008), or positive (Adams and Mehram - 2008) effect on the value of banks. The findings of the aforementioned studies suggest that bank value is strongly related to the performance of boards of directors in their advising and monitoring role, still related to boards' composition.
Nevertheless, there is no such thing as a perfect composition which can be adopted by banks at a second stage because of the different nature, needs and environment each bank is operating in (Pearce and Zahra - 1992). The board composition is endogenously determined (Hermalin and Weisbach - 2003). In addition, the composition depends not only on internal but on external contingencies as well. (e.g. (i) the legal system of the country in which the parent bank is established, (ii) ownership structure, (iii) complexity of the organization as an internal factor etc).

2.2.1 Advisory Board

One of the main roles of the boards is to ensure that the respective council and access to resources and information is duly provided to the Executive management. Such task seems to be better performed by more independent and larger boards which may provide more connections and much more knowledge, expertise and information (Guest - 2008). Pursuant to

previously conducted studies, advisory needs of the bank are positively linked to the size of the organization (Kim et al., 2007; Guest – 2008; Coles et al. - 2008;) and its complexity. In addition as we mention above in the banking industry board is a unique tool to advice managers in identifying and implementing strategies (Andrés and Vallelado, 2008).
We may infer that the more complex and larger the banks, the greater will be the need for, as well as the benefit from the advisory board. This will lead to having more independent and bigger boards *(Research Question No. 1)*.

2.2.2 Monitoring Board

The finding of researchers suggests that the monitoring role is performed with more efficiency by independent and larger boards (Raheja - 2005; Guest - 2008;). Some of the benefits we can mention are (i) more connections leading to more business; (ii) political influence with a supervisory entity etc. Thus, we may assume that banks located in countries with poor supervisory authorities need larger and more independent boards.
In addition, from the studies it is perceived that ownership concentration may work as a governance tool that can substitute monitoring role of the Board. On one side, when there are fewer shareholders, there are fewer board directors. This will decrease the decision-making costs (Kieschnick and Moussawi - 2004) as well as the number of independent directors (Belkhir - 2009).
Following these arguments, we can hypothesize that banks with concentrated ownership do not need a monitoring board, hence they may benefit from a smaller and less independent board. *(Research Question No. 2)*

In addition, investing on board with the aim of meeting the needs of the monitoring role will be closely linked to the monitoring costs. If the costs are high, then the monitoring configuration and, consequently, the monitoring role will be subject to reduction, thus resulting in a reduction of the boards' independence and size. (Raheja – 2005). Thus the monitoring costs affect the growth of the organization, by having a negative impact on the size of the board.

(Linck et al., 2008; Guest, 2008). The findings do not specifically refer to banks. We have applied these findings in the banking sector since we believe that the managerial issues of both sectors greatly overlap. As a conclusion, we may assume that growing banks need to increase their monitoring costs, which leads to the board becoming less independent as well as smaller in size.

Chapter 3

The Board Composition

3.1 Introduction

According to The Eversheds Board Report "*Larger boards were likely to have a lower percentage of independent directors, but a higher proportion of directors with 'relevant industry experience'. In this research, a higher proportion of independent directors emerged as a common characteristic of better performing companies over the financial crisis*".

Smaller boards seem to be more effective*: "Directors point to the fact that a board is a collection of people and smaller groups lead to more active engagement of each individual. The role the Chair plays is crucial on an effective board, drawing out contributions from the non-executive directors who possess the relevant skills and creating a culture of constructive challenge. For this to be a success, the Chair has to have a close relationship with each of the directors, which is made difficult when there are a large number of directors". (The Eversheds Board Report – 2010)*

To our understanding, researchers suggest that bank's boards are to a great extend different from those of non financial organizations in terms of bigger size and the increased number of independent directors. The mean number in banking industry varies from 16 to 18 directors (Andrés and Vallelado - 2008; Adams and Mehram - 2008), which seems to be higher than the normal board size which varies from 11 to 13 for big non-financial companies (Andrés et al., 2005; Coles et al., 2008).

The average proportion of independent directors on the board of a banking organization is around 70 to 85% (Andrés and Vallelado - 2008; Adams and Mehram - 2008; Belkhir - 2009), which is again higher than the mean of outsiders varying from 60 to 70% of the total number board members in the non-financial firms (Andrés et al.- 2005; Coles et al.- 2008;).
In addition, as otherwise discussed here in above, the regulator as an extra governance mechanism plays a major role to the differentiation between the compositions of boards in financial institutions versus non-financial firms worldwide.

In this context, boards should be configured in an optimal way so as to enhance their advisory and controlling role over the management as well as ensure that the bank is compliant with the regulatory framework of the country. As a conclusion we may assume that the optimal corporate governance mechanisms differ depending on organizations characteristics as well as the rest of governance mechanisms and the applicable regulatory system.
According to this point of view, the independence and optimal sizes of the banking boards are related to the bank environment and its peculiarities. In addition, major parts of the above studies find that board size has a positive association with bank's size. (*Research Question No. 3*)

The key aspect in connection with the composition of a board of directors is related to the proportion of independents participating boards and the relevant influence on banks performance. According to the Basel Committee on Banking Supervision 2006 which was reconfirmed on October 2010, "*the key characteristic of independence is the ability to exercise sound judgment after fair consideration of all relevant information and views without undue influence from management or inappropriate outside interests*".

Independent directors should have proper knowledge and abilities which are necessary to exercise their monitoring and advising role. This will enable directors to avoid or at least decrease conflicts of interest between executives and shareholders (Harris and Raviv, in press). There is no definite and unarguable evidence on the impact of appointing independent directors (John and Senbet – 1998; Bhagat and Black - 2002). On one side, a board of directors which is independent has no conflicts of interest when exercising their monitoring over managers role. Therefore, there should be a positive relation between the presence of impendent members and bank performance. On the other side, an excessive number of independent directors could harm the advisory role of boards since it will lead to an important reduction of executive manager's presence in Boards. Thus, where will be a significant lack of internal information in the board room. The studies suggest that executive directors are the link between the management and the board. (Adams and Ferreira - 2007; Coles et al. - 2008).

In addition, an excessively large board can show flexibility problems and may be not functional. In other words the directors may loose their incentive to be engaged and duly perform their role.

Therefore we can assume that there is a negative relation between the excessive board size or excessive presence of independents and the value of the Bank. (Research Question 4). This however, shows the trade-off between disadvantages and advantages in the, excessive presence of independents in boards and its size. It is clear that there should be an optimal configuration which should fit the respective bank pursuant to its size, nature of doing business, environment of operation and other internal factors.

3.2 The Board independence and the role of the independent directors

According to Evershed Report, the empirical evidence suggests that, even though not clearly, the increase of the impendent directors is positively linked with the organization performance. The findings of the relevant survey suggest that the independence is chosen over the relevant industry experience the directors may have.

According to said report, the findings of the survey performed in 241 boars of companies show that the companies which performed better had a greater proportion of independents. (refer to the Table 1)

Table 1

Percentage of directors on the board who are considered independent

	Number in sample	Average share price change	Independent directors: 2007	Independent directors: 2009
ALL	241	-9.0%	60.8%	63.3%
UK	75	-2.6%	56.1%	60.6%
UK (FTSE 100)	50	-5.2%	57.0%	61.7%
UK (FTSE 250)	25	2.5%	54.3%	58.4%
EUROPE	50	-29.0%	48.6%	52.2%
US	51	-7.6%	84.5%	86.6%
ASIA-PACIFIC	50	0.3%	57.6%	57.3%
ASIA-PACIFIC (Australia)	25	-15.0%	75.9%	76.4%
ASIA-PACIFIC (Hong Kong)	25	15.6%	39.3%	38.1%
BANKING AND FINANCE	50	-29.1%	61.1%	62.2%
ALL ex. banking and finance	191	-4.3%	60.6%	63.5%

According to the Basel Committee on Banking Supervision 2006 which was reconfirmed on October 2010 "*The bank should have an adequate number and appropriate composition of board members. Unless required otherwise by law, the board should identify and nominate candidates and ensure appropriate succession planning. Board perspective and ability to exercise objective judgment independent of both the views of executives and of inappropriate political or personal interests can be enhanced by recruiting members from a sufficiently broad population of candidates, to the extent possible and practicable given the bank's size, complexity and geographic scope. Independence can be enhanced by including a large enough number of qualified non-executive members on the board who are capable of exercising sound objective judgment. Where a supervisory board or board of auditors is formally separate from a management board, objectivity and independence still needs to be assured by appropriate selection of board members*" (Basel Committee on Banking Supervision 2006)

The OECD Principles of Corporate Governance share the view of having a sufficient number of independent members seating the board so as for them to ensure that their role is duly performed during the decision-making process.

"*An enquiring, probing mind is also a requisite attribute. An independent director should not be afraid to ask the relevant questions of management and challenge the accepted thinking of executives. Independent directors must be prepared to say "no" to management when appropriate. However, it is important that issues are deliberated carefully with management and other directors and that the decisions of independent directors can withstand scrutiny*".

"The independent director's role also is not for the faint hearted. Investors rely on their vigilant oversight to ensure the responsible management of their assets. Their responsibility is significant – and the consequences of failure can be severe, especially for the investors they are charged with protecting. They play an important function in safeguarding the financial reputation of the company" (The OECD Asian Corporate Governance Roundtable 2007)

3.3 Split of Roles between CEO and Chairman of The Board

"What you need is complementary but constructive healthy challenge, debate and discussion... CEOs, they sometimes drink their own Kool-Aid as the Americans say... and you then end up with a lot of groupthink or they stop listening and you need that sort of chairman role to be able to challenge the CEO and bring them back down to earth. It is really very important to ensure there is a balance of power because absolute power does corrupt absolutely."
Mike McTighe, Chairman, Pace plc.

One very interesting point in the debates that have turned out to conclude to a common agreement is the so-called spit role of the CEO and chairman of the board of directors. Especially in US there are cases where the CEO is acting also as the chairman of the board. In this regard the studies suggest that increased difficulties in governance could be expected. According to relevant findings during a study on a sample of very large U.S. commercial banks which are publicly traded for the years 1988- 1990 (Pi and Timme -1993) it is presumed that banks having a CEO holding simultaneously the capacity of the chairman of the board of directors are underperforming compared to the ones where such roles are split in different persons. On the other hand the findings of another study (Simpson & Gleason -1999) find that this dual role of the CEO may result to bring down profitability or even financial distress. According to these points of view the CEO concentrating the power of both positions is more keened to take less risk so as to ensure a long term in those positions. Their final recommendations call for regulator's intervention in order to prevent financial distress in the banking sector. In addition, an organization having a sound corporate governance stem including the split role between the CEO and Chairman of the BoD, can have a very good potential in having a better monitoring of management. At a later stage another study (Griffith et al. - 2002) base their proposal on evidence regarding the insignificance of the relationship between both capacities.

Even though the statistical analysis provided by the Eversheds Board Report - 2010 did not prove any association between the organization's performance and that splitting roles among CEO and Chairman of the Board, the directors, during a query conducted voted in favour of having a divided role. According to this study conducted on 241 Boards, there was no sufficient correlation between firms having a split role performance so as to conclude that the companies not having a split role were underperforming compared to the ones that have a CEO who is playing both roles simultaneously. Results of the survey are shown on Table 2.

The findings on companies which tend to apply a split role were the following: Around 24% of US firms that were applying a split role in 2007 were mainly in the banking and finance sectors and technology. According to this study this element votes in favour of the lack of a clear association between a split role and performance of the share price as during that period Banks were underperforming while technology and software firms were enjoying their peak.
Most of directors which took place in the relevant survey were in favour of having a split role between the CEO and the chairman of the BoD as they were of the opinion that those roles were clearly different. In addition, they thought that it was vital to have a Chairman who could

challenge the opinion and actions of the CEO. Directors also were of the opinion that the role of the Chairman was to run the board and the one of the CEO is that of running the business. Another argument supporting their opinion was that the Chairman/CEO roles should be split so that less concentration of power may occur.

Given the above we may assume that even though no strong correlation is provided by the relevant literature, the split role can have a positive impact in the value of the firm. (Research Question No. 5

Table2.

Percentage of companies with split CEO/Chair

	Number in sample	Average share price change (%)	2007	2009
ALL	241	-9.0	70	71
UK	75	-2.6	97	98
UK (FTSE 100)	50	-5.2	98	96
UK (FTSE 250)	25	2.5	96	100
EUROPE	50	-29.0	72	72
US	51	-7.6	24	22
ASIA-PACIFIC	50	0.3	78	82
ASIA-PACIFIC (Australia)	25	-15.0	100	100
ASIA-PACIFIC (Hong Kong)	25	15.6	56	64
BANKING AND FINANCE	50	-29.1	74	78
ALL ex. banking and finance	191	-4.3	70	70

CHAPTER 4

Boards Meetings

The internal functioning of the board is a very crucial issue on the performance indicators of a board and deserves the proper attention by the researches. Indeed studies suggest that there are many factors which have a major impact on boards which define their operation. One of these elements having a particular importance is the frequency of the boards meetings (Vafeas - 1999).

During the examination of the boards' activity someone can come up with arguments that support or refute the assumption that there is a positive relationship between the frequency of meeting and the performance of the board. During the meetings the board's members have the opportunity to exchange opinions and ideas on how the monitoring role is being carried out and also to define future strategies. Consequently, the more frequent the meetings, the closer will be the control over managers, thereby ensuring a positive relationship between the frequency of meetings and the performance of the Board. In addition, the information exchanged in the boardroom, given that banks are complex businesses, impacts significantly in a positive way the board's advisory role. On the other hand, though frequent meetings may also be an indicator that the board is reacting to poor performance having that way the latter play a reactive role.

According to the Basel Committee on Banking Supervision 2006 which was reconfirmed on October 2010:

"*The board should maintain, and periodically update, organizational rules, by-laws, or other similar documents setting out its organization, rights, responsibilities and key activities.*
The board should structure itself in a way, including in terms of size, frequency of meetings and the use of committees, so as to promote efficiency, sufficiently deep review of matters, and robust, critical challenge and discussion of issue".
Taking into consideration the above discussions, we may hypothesize that the frequency of the meetings, if not otherwise provided by the law, is defined by the particularities of the environment each organization is operating in. Anyhow, the meetings should be sufficient so as the board may duly perform its key roles. The meetings should be attended by sufficient quorum as defined in the respective law. However, it is of a paramount importance all the members to attend as each of them have a special role to play and contribution to give in the board room.

CHAPTER 5

The Board performance and how directors can be evaluated

5.1 Why Evaluate Boards

In Basel Committee document on Banking Supervision 2006 which was reconfirmed on October 2010 is stated:

"To support board performance, it is a good practice for the board to carry out regular assessments of both the board as a whole and of individual board members. Assistance from external facilitators in carrying out board assessments can contribute to the objectivity of the process. Where the board has serious reservations about the performance or integrity of a board member, the board should take appropriate actions. Either separately or as part of these assessments, the board should periodically review the effectiveness of its own governance practices and procedures, determine where improvements may be needed, and make any necessary changes".

The need for effective board evaluation is identified as one of the lessons learned from the global financial crisis. The created economic situation which is deemed to be a result of inadequate board functionality indicates the need for increasing the board accountability. This is reflected even in the recent local Banking legislative and regulatory changes which acknowledge the growing expectation that boards should monitor management as well as take full responsibility for the monitoring of their own performance.

The OECD (2009) recommends that "*A board evaluation process, conducted with the support of independent experts on a regular basis, should be used as a structural tool for monitoring board effectiveness and efficiency*." In addition, the Walker Review of Corporate Governance in the UK Banking Industry (2009) implies for having a more adequate system of board evaluations and better share of information with the stakeholders as to such evaluation.

To assess if a board is performing effectively, there is a need to understand what the board should achieve (i.e. the role of the board). As previously discussed a board has two main roles:

(i) to monitor and control management (control role); (ii) to provide advice and relations with external resources (service role).

5.2 The reasons Causing Governance to fail

Governance failures may result mostly in reduction of shareholder wealth. There are also a wider range of economic and social consequences that have as final destination the closure of businesses, loss of retirement benefits and jobs. Taking into consideration the wide range of reasons causing a corporate to fail, it is of an outmost importance to seek for the reasons which lie beneath the board performance. There are many categories related to such failure directly connected to inadequate performance of one of the following roles such as: (i) strategic and (ii) control (e.g. inadequate risk management system), (iii) ethical (risk of having reputational damage) and (iv) interpersonal relationship (lack of Board independency). The reason why lately a major importance is given to the Board evaluation is that they provide a process for boards to identify and isolate sources of failure. In addition, they enable boards to diagnose potential issues before the latter reach the crisis point. An evaluation which is well-designed and covers both, board as a body and individual board members evaluation, is likely to raise the issue of ethical concerns among some directors in relation to others or management. We can use the same argument for failure related to interpersonal relationship. A well designed board evaluation can serve to identify any potential issue and encourage discussion leading most likely to resolution before they turn into major crises. Board evaluations are not a universal solution for all board disfunctionalities. Nevertheless, if evaluations are used on regular basis and in a correct way, they may have a major impact on preventing governance failure.

5.3 Corporate Performance and Board Evaluation

As we mention above, prevention of corporate failure is not the only responsibility of boards. One of the main board focuses is the corporate performance and this fact emphasizes the role of the evaluation of the Boards as strictly related to corporate performance for many reasons: (i) It is well known that Boards are held accountable for corporate performance. Therefore they have become more proactive in the leadership of the companies which they govern. Until the recent years, the CEO's, were seen as the only responsible persons for these areas. Today, inspired by developments in agency theory (Hendry - 2002), and fuelled by tales of corporate excesses such as Hollinger International (Aylmer - 2004) and (Bianco, Symonds, Byrnes and Polek - 2002), there is an increased demand from all the stakeholders that boards demonstrate leadership and control. (ii) Second, there has been a very important increase lately in the shareholder involvement which comes as a consequence of the power increase of large institutional investors, who are becoming more demanding of boards.

Institutional investors are pretty convinced that the board can have a direct impact in the increase of the shareholder value by providing strategic solutions, guidance and selecting and monitoring the CEO as well as by intervening in the event of crisis (Conger, Lawler and Finegold - 2001). As a consequence, more than 80 % (eighty per cent) of US and European institutional investors are willing to invest more in companies with good governance (Economist Intelligence Unit - 2001). The duty for boards to improve their performance is further emphasized by the ability of stakeholders to assess the corporate governance practices of major corporations through ratings systems such as those developed by Standard & Poor's (2003) and the Corporate Library (2004), which rate board effectiveness using factors such as board composition, director tenure and CEO compensation.

In addition companies such as WorldCom, Enron, and Tyco International, have sealed in the peoples memory the failure in corporate governance reflected in the ethics dimension and boards, in all cases, seem to be in the firing line. There is an increasing trend for the society to put the blame for poor corporate directly on the board. It appears that the stakeholders expect that boards should be held accountable for the performance of the companies they govern.

For these reasons board and its committees evaluation is becoming a very important tool to assist boards in improving their performance. This global trend sees specific board evaluation recommendations forming a key component of nearly every major corporate governance review or report. For example, the *Principles of Good Corporate Governance and Best Practice Recommendations* (ASX Corporate Governance Council, 2003) in Australia, the *UK Corporate Governance Code*, 2010 in the U.K., and the *Principles of Corporate Governance (A White Paper from the Business Roundtable - May 2002)*) in the U.S., *the EU Corporate Governance in Financial Institutions and Remuneration Policies* (Green Paper) - Brussels - June 2010, all make specific recommendations for the regular review of board performance.

The benefits of having board evaluated are numerous. If conducted properly, board evaluations can have a major impact on corporate performance on three levels (i) individual director level, (ii) Board level and (iii) on organizational level. Boards which are committed to perform a regular evaluation process find benefits across these levels in terms of having improved leadership, improved teamwork, greater accountability, greater clarity of responsibilities and roles, improved communication, better decision-making, and more efficient board operations. In Appendix 2, we show the benefits of board evaluation to the organization, the board as a whole and to individual directors. It should be mentioned, however, that such benefits can only occur only in case such evaluations and assessments are properly executed.

Chapter 6

Banking System in Albania

Banking is a very important activity in Albania. The entire 16 commercial Banks are privately owned with the share of foreign ownership standing at about 95%. Around 73% of sector's foreign assets are held by EU-based banks, while Greek and Italian banks represent more than 30% of foreign claims. While being generally well-capitalized and liquid (the ratio of liquid assets to short-term liabilities stands at well above the minimum regulatory level of 20%), deposits which have increased at a fast pace remain a main source of financing, with the credit-to-deposit ratio standing at roughly 58% (Sep-12).

Credit risk remains a major cause for concern, with non-performing loan ratio of around 22.7% (Sep 2012). The banking system continues to be increasingly prudent regarding crediting, although its balance sheets remain sound and able to encourage credit growth.

Lending to business remains the major driver of credit growth. Household credit increased at a more subdued pace (i.e. 5.3%), well below historical values.

However, demand for new loans in both segments (households and businesses) is assessed to be in low levels compared to previous periods. (Source - Bank of Albania)

The Law 9662 “On Banks in the Republic of Albania” which was recently amended on December 2011 (hereinafter referred to as “The Law On Banks”) aims at aligning the banking legislation in Albania with the Community law. The law is also in conformity with the Basel core principles and European Union directives. The law is also in alignment with the Albanian legislation as a whole set of legal norm, which, among others provides for supervision of financial activities and licensing by other entities, (i.e. the Deposit Insurance Agency and the Financial Supervisory Authority). Taking into consideration the major importance of financial entities, the law incorporates the best applicable practices of the region and European Union as regards corporate governance issues.

Generally it seems that all banks in the Republic of Albania are operating under a regulatory framework which includes but is not limited to laws, regulations, procedures and practices that determine Corporate Governance. Banks, being compliant with the legal and regulatory framework have clear reporting lines, and are well audited by internal and external auditors which may have direct access to the Directorate and to the Supervisory Board (Board of Directors).

According to the aforementioned Law, the banks in the Republic of Albania are directed by a two tier management system. The Directorate which may be composed by one or more directors and constitute the executive direction of the Bank and the Steering Council which is the Supervisory Board of the Bank. The law has defined the Audit Committee as a separate body reporting directly to the Steering Council. The Steering Council, having decision-making and monitoring attributes is composed by an odd number of members, not less than 5 and not more than 9 members. The Steering Council elects from its members one Chairman and one Deputy Chairman who presides over and steer the debate during the meetings for the Steering Council.

It is a requirement of the Law for the members of the Steering Council, during the performance of their duties to comply with the highest ethical standards and act upon sufficient and adequate information, in good faith, with the due care and responsibility, fully committed to their responsibilities, in the best interest of the safety and sustainability of the banking and financial activity, of the clients and their shareholders(Law on Banks in the Republic of Albania).

It is clearly shown here that the legislator has upgraded the Clients as the main stakeholders who need to be protected by the power of law. This, we presume, is one of the characteristics financial institutions have, given their important role explained herein above. In the Steering Council duties and responsibilities section, the law has granted such body with monitoring and decision-making authorities which seem to be more strategic and general rather than individual. The power of managing the daily business of the bank rests with the Directorate. The Steering Council may create Committees for special purposes in order to perform its duties. Given that the committees receive the delegation on the topic of concern from the boards it is quiet clear that they act as an extension of the boards by facilitating them in the execution of their role. The committees generally assume responsibility for seeking and reviewing information, forming an opinion and making a recommendation to the board. The efficient use of committees can greatly increase the board’s ability to effectively address the diverse areas of its mandate. However, it is important to understand that even though the board has delegated part of its responsibilities to committees, the board remain responsible for monitoring and implementing the relevant issues subject to the delegation.

The Organisation we work in has many committees, (Appendix 3 shows a list of committees in force, their configuration and frequency of meeting), which help the board during the performance of its duties. This is a way for the Board to advise executives (by having in the committees people with expertise on the subject) as well as monitor them during their daily business. In addition, instead of having only one General Manager taking decisions, there is an entire environment created per each subject, in which the executive (CEO) has very diminished probabilities in committing huge mistakes or even abusing with the power.

In addition, the second chapter of the recently amended regulation of the Bank of Albania "On the Core Management Principles of Banks and Branches of Foreign Banks and the Criteria on the Approval of their Administrators" deals with the core principles and regulations of a responsible and effective management. This chapter aim to strengthen the requirements for the managing bodies of the banks. This may be achieved through a major focus on the more effective supervision from the Steering Council (BoD) and combination of the experience of its members in order to ensure a suitable level of qualification of the board of directors. The chairman of the board of directors is vested with an important role: i.e. he must promote and encourage the critical thinking and expressing of different point of views in the decision-making process of the bank. Board of directors should be informed by the directorate on the important matters related to banking operations, risk management, implementation of strategies and policies, as well as any on deviation from the adopted objectives. For an optimal applicability of the core principals the board of directors and the directorate decide to act in close support with the control units of the bank.

This chapter also deals with the establishments of different committees of the bank, such as risk/s committee, the remuneration committee, nominations committee, ect., which shall advise/assist the BoD on specific issues. The bank shall be obliged to publish in their Annual Reports the names of the committees established under the BoD, their mandates and their composition. Such committees may be established based on the nature, size, complexity of operations and risk profile of the bank

Moreover according to said regulation remuneration policies, established and approved by the BoD shall cover all forms of remuneration, including the salary and other financial and material benefits, as well as the benefits from participation in voluntary retirement schemes for the following categories of employees:

a) executive directors of the bank;

b) employees of the internal audit unit;

c) employees performing risk- taking jobs (e.g. traders of securities, etc);

d) all employees, whose activity is deemed to effect the bank's risk profile.

The remuneration is determined based on variable and fixed components. The bank disclose in their annual reports the remuneration policies, annual aggregated amounts of compensations and rewards of the BoD and executive directors, and their remuneration forms, by explaining and backing with arguments the compliance of these remunerations with the risk management policies, the risk profile determined by the long term objectives of the bank.

Having in mind the aforementioned Research Question and discussions on the literature we shall continue with the findings on the Albanian banking system as well as with testing the Research Question discussed in the previous chapters.

Chapter 7

Findings/Data Analysis and Discussion

Given that the availability of the relevant data was restricted and not published I conducted a survey in 12 larger (out of 16 in total) Banks operating in Albania as shown in Appendix 1. The survey was done through direct or phone interviews with the department in charge for corporate affairs issues. Many times during the interviews the responsible persons seemed reluctant of providing all the information as they deemed certain issues were confidential. According to the Table of the 12 major Banks in Albania, we can see that the number of the Board members in none of the cases has reached its maximum level. This may be explained by the fact that in the major part of the cases, as otherwise mentioned here above, Banks are privately owned with the share of foreign ownership standing at about 95% and with a very limited (usually one sole shareholder) shareholding structure. As hypothesized earlier herein above, *banks with concentrated ownership do not need a monitoring board and thus, they may benefit from a smaller and less independent board (Research Question No. 2)*.

In this regard Raiffeisen and BKT are the two larger banks in the Albanian banking system (Table of the Main Competitors of Credit Agricole Albania (CAA)). As it shown in the first Table of Appendix 1, they have a Board composed by only 5 members, being that way at the very minimum level permitted by the Law. The only bank having a complex shareholding structure is Banka Credins (BC) the Board of which is composed by 7 members.

This verifies our aforementioned Research Question regarding the negative association between the concentrated ownership and the Board Size.

Given the market conditions, the Banks in the Republic of Albania are small in comparison with the huge groups operating in developed countries. As I mention above, the law sets an upper limit of nine members. As we see from the table, none of the banks have exhausted their right to use the upper limit set by the law. This finding may be explained even by the fact that in banks having concentrated ownership the board of directors does not justify large monitoring costs having in mind their size as well. Once again, the arguments regarding the positive link between the Board's size and the size of the bank stand and are reflected by the regulator even in the relevant law by setting a low cap limit (9 members) given the small size of the market in Albania(Research Question No. 1).

One issue which may be seemed by the Appendix 1 on the survey conducted in 12 larger banks in the Albanian banking system is the low number of independent members in the Board of Directors. With reference to the recent amendments on the Law "On Banks on the Republic of Albania" which have entered into force as of 26th of December 2011 it is to be mentioned that this change entails for the increase of the number of the Independent Board members from 1/3 of the total number to the majority (50% +1) of them. Now, as regards the definition the law gives for the independent directors we can clearly distinguish that it is expressed in a negative (exclusive) way and does not live room for interpretation so as to have clear criteria on which members are considered as independent. More specifically, according to the law the Independent members are the ones not having conflict of interest, therefore not being connected through private interests with the bank, the shareholders that controls the bank or its executive directors. The law gives an explicit definition of the term “Private Interest” which is to be taken into consideration by the Bank of Albania during the examination of the candidates’ documentations for the approval process. According to the definition of the Law the term “Private Interest” means the interests based on or deriving from:

a) *relationships based on wealth or commerce, direct or indirect of any nature;*
b) *any other juridical-civil relationship;*
c) *gifts, promises, favours, preferential treatments;*
d) *negotiations for potential employment or any other form of*
e) *relationship constituting a private interest for the director in the*
f) *future, after leaving the position as administrator carried out by*
g) *him whilst in the position of the administrator of the bank;*
h) *engagement in private activities with the view to profit or any other activities which generate income;*
i) *family or cohabitation relationship*
(Source: Law “On Banks in the Republic of Albania”)

Given the above, the situations creating conflict of interests through the definition of Private interest are all inclusive and do not leave room for practically having independent members.
However the practise of the Bank of Albania suggests that independent directors should be considered the ones not having any of the aforementioned private interests, having a service agreement with the Bank specifically for this task (which agreement again, if interpreted literally, may be included in the relationship referred to in item (b) herein above).

Notwithstanding the difficulties in implementing the Law, it is more than clear that this is a typical example of the regulator infringing the interests of the shareholder by not letting the latter have the major participation in the board room.

The change of the Law regarding the proportion of the participation of the independent members was approved by the Parliament on December 2011. The groups of interest were not timely informed on such amendment and therefore the Albanian Association of Banks did not have any time to resist to such change. This was considered to be far by the way such amendment should have been done and may trigger a chain reaction by the foreign shareholders given that the majority of the banks in Albania are owned by foreign shareholders.

In addition to the above, this change may discourage shareholders for having a presence in Albania given that they do not practically control the decision-making process.

By making an analysis of the way the legal and regulatory framework regulates the issue of independents, we understand that the law goes beyond the scope of the literature mentioned here above in the previous chapter, regarding the advising and monitoring role the board performs on behalf of the shareholders. It seems that the independency which the law introduces by leaving out the direct or indirect shareholders which control the bank, aims to ensure the protection of the interests of other key stakeholders/investors who are the depositors.

However, we judge that other particularities of the country are not taken into consideration when the amendment of the law was done. The level of informality and the mentality of corruption which is a major pelage of the Albanian society persist at considerable levels. By leaving the majority of board members to be independent, a fertile environment is created for giving birth to circumstances and situations which may expose independent directors to corrupt and far from the objective judgment decisions due to implications of other interests. That way the interests of the bank may be irreversibly corrupted and therefore even the interests of the depositors may be exposed from a potential bankruptcy of the bank. It is true that there are other mechanisms observing the decision-making process (i.e. the Board members are elected by the General Shareholders Assembly or the supervision conducted by the regulator etc.), which we do not think that are efficient or sufficient for ensuring the protection of the Shareholders in particular and bank's interest in general.

In addition from the Appendix 1 we can see than none of banks is respecting the requirement of having a majority of independents in the Boardrooms. This shows a clear resistance of the foreign shareholder to the changes of the law because they seem reluctant of losing control over the board and increasing the monitoring costs with outsiders. It is interesting the fact that the most part of boards have one or two executives in board. From our experience in the Banking system in Albania these executives are mostly expatriates coming from the group the bank is affiliated to.

As regards the meetings frequency from the available data reflected in Appendix 1 we can see that there is an average frequency of 6 meetings per annum. Again we can see that the two major banks Raiffesien and BKT, have the lower frequency of meetings. Thus these banks organize only the necessary meetings on quarterly basis so as the management can report to the board. We believe that these banks have a lower participation of the board in exercising their monitoring and advisory role, while the management seems to have more free hands in the running of the business. However being part of larger groups the monitoring process may be exercised through the homologue units of the parent bank.

According to the survey, in certain cases it is declared that they organize trainings for the non-executive senior management (Directors of Departments/Units), but most part of them do not bring any information or avoid responding when it comes to the question on the training of the Board members. In certain cases they mention that the expertise in certain field or the experience was the reason they were elected in the relevant position. Therefore they need no further experience. As a matter of fact, the Law “On Banks in The Republic of Albania” and the regulation “On the Core Management Principles of Banks and Branches of Foreign Banks and the Criteria on the Approval of their Administrators” provide for the criterion an administrator [1] of the bank should comply with. This regulation was recently amended by providing a more clear and all-inclusive framework of corporate governance system in the banking industry in Albania. The aforementioned regulation stipulates the following:

[1] The term “Administrator” includes the members of the BoD and Directorate.

“Any individual enjoying a high ethical and professional reputation, with qualification and professional experience in management, may be an administrator of a subject (understand Bank).

Qualification and professional experience in management should be sufficient and suitable to the nature, sizes and complexity of subject activity, as stipulated in paragraphs 3 and 4[2] of this Article” (Regulation of The Bank of Albania “On the Core Management Principles of Banks and Branches of Foreign Banks and the Criteria on the Approval of their Administrators”)

It is true that the regulatory framework provides for certain criterion a candidate member of the board would comply with so as to be elected as one permanent member for the assigned term. This is ensured even by the prior approval the Supervisory Body grants before the board member becomes effective. Nevertheless there are certain areas which are not covered by said regulation.

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3. [2] *The proposed administrators shall deemed to own sufficient and suitable qualification and professional experience, in the event of meeting the following criteria: ``*
   a. *hold a university degree or have at least accomplished the programme of second cycle of higher education institutes (in the case of administrators being Albanian citizens) in law or economics, and have (work) experience of at least **5 (five) years** in one of the following sectors:*
      i) *banking/financial system,*
      ii) *risk management in the financial markets,*
      iii) *financial management,*
      iv) *auditing,*
      v) *banking/financial supervision,*
      vi) *legal or academic experience related to financial market; or*
   b. *hold a university degree in a field different from the legal or economics sciences, and have an experience in banking sector, for at least 5 years.*
4. *The administrators proposed to hold the position as a member of steering council or of the Directorate, along with the criteria set out in paragraph 3 of this Article, shall be considered to own a sufficient and suitable managing experience in case they meet at least one of the following criteria:*
   a. *have held a managing position for at least 3 (three) years in the financial institutions that operate in the domestic or cross-border financial market;*
   b. *have held a managing position for at least 3 (three) years in one of the supervision authorities of the banking/financial market in Albania or in an other country;*

have held a managing position for at least 5 (five) years in legal persons different from those mentioned in “a” and “b” of this paragraph

Notwithstanding the aforementioned arguments, it would be necessary for banks to have a clear focus on having Directors trained on governance issues; such includes information on the way they should behave in a board room, the encouragement of their critical thinking, the transiting of the advice to the managers, their communication, their constructive analysis etc.

As already mentioned in this paper, The Law “On banks in the Republic of Albania” provides for a two tier management system with the Directorate being the executives of the Bank and the Steering Council (Board of Directors) the monitoring body which additionally takes strategic decisions. In this context, the Executive Director, (who may be the chairman of the Directorate or the CEO in the event the Directorate is composed only by one member), cannot simultaneously hold the position of the Chairman or that of the Deputy Chairman of the Bard of Directors. As it may be easily understood, the Albanian Legal/regulatory framework provides for no such institution as the “duality” of the CEO/Chairman which could help us verify our Research Question No 5.

In addition, we can see at the end of the Chapter 6 “Banking System in Albania” that the provisions of the Law and the recently amended regulatory framework define the main milestones the board of directors should step in so as to duly perform its duty and responsibility. We can easily identify the special attention the regulator gives to the role of Chairman of the board which is a separate one from that of the directorate (CEO). Therefore we cannot verify Research Question No. 5

We discussed thoroughly in Chapter 6 the importance of having the Board evaluated. In the Albanian Legal framework this issue is not regulated. It seems that the regulator has not intervened in this aspect by letting its adjustment to the policies and practices each bank applies.

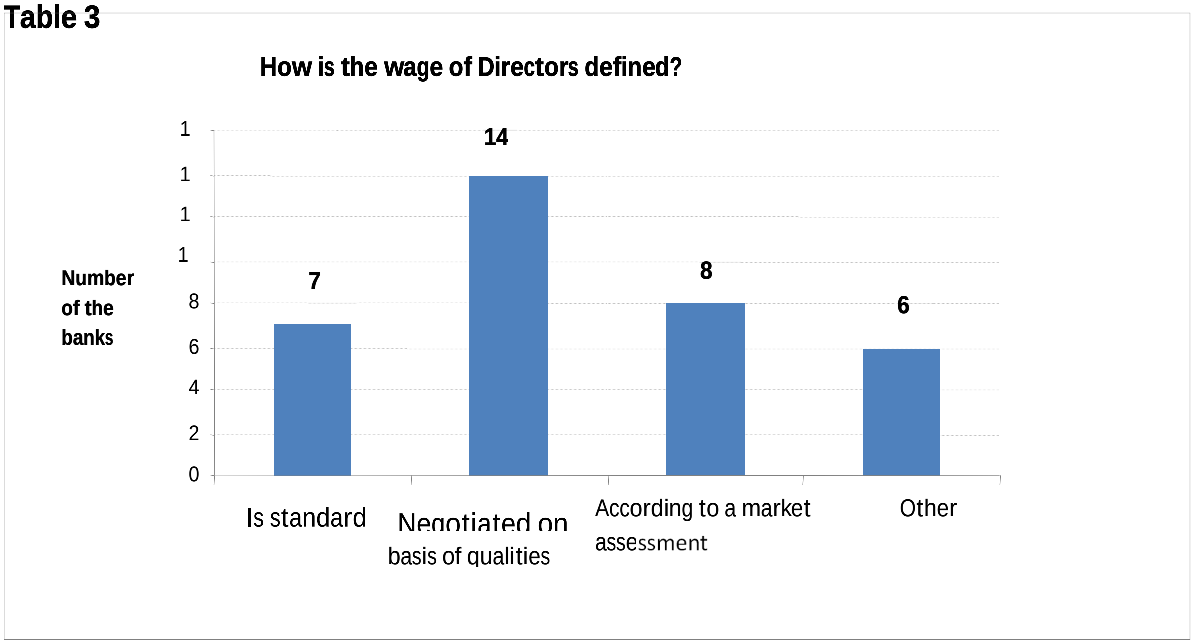
Although the recent amendments on the legal and regulatory frameworks were a step forward to the enhancement of the regulatory system concerning corporate governance, certain issues were left out of regulation. These issues refer to the remuneration policies concerning the members of the Board of Directors, training, evaluation etc.

From the survey we conducted it appears that the Banks have no practices to perform Board Evaluation. Maybe this is a result of the concentration of the ownership in the major part of the banking system.

Even for the issue of remuneration the findings were ambiguous except for some general responses which again do not represent the major part of the Banks. According to these responses, in general the Board members which have an employment contract with the shareholder are not paid additional fees, whilst, the ones that are independent are paid through fixed tariffs per meeting. In our bank, since the major parts of the Board members are having an employment contract with the direct shareholder, the directors are not being paid additional fees for their participation in the Board of the affiliate company.

According to the survey conducted, only 2 banks out of 12 have defined the remuneration policy for the CEO and 4 of them for the Board of Directors on the basis of short-term results. Based on these findings the remuneration policy review is done each year, once the financial statements are approved by the Shareholders Assembly. Major part of banks determine CEO and Steering Committee remuneration based on long term results (See results of the Survey in Table 3).

Table 3



Source: Bank of Albania Survey (2011)

CHAPTER 8

Conclusions

As we discussed in this paper the great importance banks have in the country's economy and the complexity of their nature is a good reason for them to be regulated. Even though major steps have been done in terms of legal and regulatory intervention in the framework of the country's aspiration to be a member of the great European Union family, there are new challenges for the system of corporate governance of banks. On the other hand, continuous restriction and regulation is a challenge for banks themselves. For instance, the emergence of issues of conflict of interest between the regulator and shareholders we discussed above is a key indicator alerting the need of establishing good practices which would keep balances intact, by preventing that way the excessive regulation which might be the trigger for generation a major corporate governance failure.

In corporate governance, boards of directors of banks are one of the key players in the governance of the bank by advising and/or monitoring managers or even by strategically leading the bank toward new goals. According to the Research Question mentioned in this paper the main characteristics of bank boards such as composition, size etc, reflect the board performance or other particularities the bank has (Research Question 3). After introducing a general presentation of the Albanian Banking system and the survey on 12 out of 16 of major banks we could find we can see that the number of the Board members in none of the cases has reached its maximum level. This was explained by the limited shareholding structure. As hypothesized earlier herein above (Research Question No. 2), *banks with concentrated ownership do not need a monitoring board and thus, they may benefit from a smaller and less independent board*.

Our findings suggest that the two main banks have a Board composed by only 5 members, being that way at the very minimum level permitted by the Law. The only bank having a complex shareholding structure is composed by 7 members. This verifies our aforementioned Research Question No. 2 regarding the positive association between the concentrated ownership and the Board Size. This overcomes the previous Research Question (at least for the banking system in Albania), regarding the positive relation between the bank and the board sizes and the need for the advisory board (Research Question No. 1, No. 3). In addition another argument we used for this was that the cost of monitoring are not justified in organizations with the concentrated shareholders.

We additionally assumed in Research Question No. 4 that there is a negative association between the excessive board size or excessive presence of independents and the value of the Bank and we showed the trade-off between disadvantages and advantages in the excessive percentage of independents and excessive size of the board, as well as that there should be an optimal configuration which should fit the respective bank pursuant to its size, nature of doing business, environment of operation and other internal factors. In Albanian banking sector we observed that the number of independents is pretty low due to the small size of banks and concentrated ownership. Furthermore, the upper limit permitted by the law is only 9. Therefore, the size of Boards in Albania is pretty low because is regulated by the law due to relatively small size of banks, thus the increase of the size of Boards (up to 9) does not jeopardise its functionality and flexibility. As regards the possibility of banks having excessive participation of independents, as it is shown in Appendix 1, none of banks is compliant with the relevant provisions of the law as we will further elaborate on here below. Again there is no such issue as the presence of an excessive participation of independents or an excessive size of the Board in the Banking system in Albania, which could help us verify our hypothesis.

Moreover in this paper we discussed about the independence of the board of directors and the positive relationship in the bank's value (Research Question 1). We raised some issues concerning the clarity of the definition of the independent members in the banking legal framework in Albania and the conflict caused with the shareholders interest. Our interpretation to this problem is that the law is not aligned with the general principles of the Basel Committee which states that: "*the key characteristic of independence is the ability to exercise sound judgment after fair consideration of all relevant information and views without undue influence from management or <u>inappropriate outside interests</u>*".

We judge that the restriction set by the law as to shareholder participation in the board goes beyond the requirement of having the public interests protected. In fact, taking into consideration the level of informality and corruption existing vastly mainly in public sector, the significantly reduced monitoring of the shareholder this regulation might create, is a fertile environment for inappropriate outside interest to grow. Therefore the public's interests might be in danger after all.

The findings from the analysis of the literature and the ones of the banking system in Albania lead us to conclude with some recommendations as follows:

- ✓ Although Albanian banking sector is characterized by banks with concentrated shareholding structure, the need for the banks to increase the number of members up to the cap boundary is advised so as to make use of benefits (increased advisory and monitoring roles) that such increase may secure to the Banks. This number is relatively small and does not work against bank's flexibility in decision-making process;
- ✓ Banks should increase the number of independents in boards which move will create more value to them. We are of the opinion that the shareholder should have the majority participation in the board room so as the interests of all stakeholders to be better protected. Therefore, there is further need for the relevant provision of the law to be changed and adopted to the Albanian conditions; In addition the relevant definition of "independent members" should be clarified by the regulator.
- ✓ Given that none of banks had an evaluation policy for the members of the board, such policy should be adopted by them so as to make use of the advantages we discussed in this paper.
- ✓ Training and clear remuneration policies should be implemented in order to have an active and updated board where critical thinking and constructive discussions are the main tools for the board to perform their role.
- ✓ Although the regulator has made a step forward in implementing an all inclusive set of corporate governance rules in the last amendment of the regulation "On Core Management Principles of Banks and Branches of Foreign Banks and the Criteria on the Approval of their Administrators", there is still room for improvement by including other areas in such as Board evaluation, remuneration policies etc., which according to our opinion, should be regulated as well. However, the particularities of the banking system in Albania and the relevant environment banks are operating in should be taken into consideration before any regulation enters into force. Banks should be part of an interest group to be consulted with when such regulations are being elaborated at pre-legislative phase.

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APPENDIX 1

Table of 12 Major Banks in Albania

		RZB	BT	SocGen	ISP	BKT	BC	BPI	BU	PCB	Banka Veneto	BBSH	CAA
1	Members No.	5	7	5	5	5	7	5	7	5	5	7	7
2	No. of Executives	0	2	2	1	1	2	0	1	0	0	1	2
3	No. of Independents	0	2	1	0	0	4	0	0	0	3	4	1
4	Meetings per Annum	4	7-8	No Info	No Info	4		7-8	No Info	4	No Info	No Info	6
5	Performance Evaluation	*Not Applicable. The Only evaluation is done by the Bank of Albania for the board as a body not referring to individual assessment.											
6	Remuneration	*There is no clear information for such issue. In general the Board members which have an employment contract with the shareholder are not paid additional fees, whilst, the ones that are independent are paid through fixed tariffs per meeting											
7	Board Trainings	The trainings are not done											

Table of the Main Competitors of Credit Agricole Albania (CAA)

Main competitors	Loans 2012 Q3	Deposits 2012 Q3	Branches 2012 Q3	ATM's 2012 Q3
RZB	23.60%	29.70%	18.50%	24.18%
BKT	15.60%	19.50%	14.70%	10.28%
Intesa Sanpaolo (ISP)	8.60%	11.90%	5.60%	6.41%
SocGen	5.80%	5.10%	7.70%	6.53%
Banka Tirana	9.80%	7.20%	10.10%	10.28%
NBG	4.70%	3.10%	4.90%	4.11%
CAA	4.10%	1.60%	4.00%	4.47%
Total Banking system	4,117.10	7,094.60	556	827 (Q3)

Appendix 2

Table 1: Potential benefits of board evaluation

Benefits	To organisation	To board	To individual directors
Leadership	• Sets the performance tone and culture of the organisation • Role model for CEO and senior management team	• An effective chairperson utilising a board evaluation demonstrates leadership to the rest of the board • Demonstrates long-term focus of the board • Leadership behaviours agreed and encouraged	• Demonstrates commitment to improvement at individual level
Role clarity	• Enables clear distinction between the roles of the CEO, management and the board • Enables appropriate delegation principles	• Clarifies director and committee roles • Sets a board norm for roles	• Clarifies duties of individual directors • Clarifies protection of directors • Clarifies expectations
Teamwork	• Builds board/CEO/ management relationships	• Builds trust between board members • Encourages active participation • Develops commitment and sense of ownership	• Encourages individual director involvement • Develops commitment and sense of ownership • Clarifies expectations
Accountability	• Improved stakeholder relationships, e.g., investors, financial markets • Improved corporate governance standards • Clarifies delegations	• Focuses board attention on duties to stakeholders • Ensures board is appropriately monitoring organisation	• Ensures directors understand their legal duties and responsibilities • Sets performance expectations for individual board members
Decision making	• Clarifying strategic focus and corporate goals • Improves organisational decision making	• Clarifying strategic focus • Aids in the identification of skills gaps on the board • Improves the board's decision-making ability	• Identifies areas where director skills need development • Identifies areas where the director's skills can be better utilised
Communication	• Improves stakeholder relationships • Improves board-management relationships • Improved board-CEO relationships	• Improves board-management relationships • Builds trust between board members	• Builds personal relationships between individual directors
Board operations	• Ensures an appropriate top-level policy framework exists to guide the organisation	• More efficient meetings • Better time management	• Saves directors' time • Increases effectiveness of individual contributors

Source: Kiel, Nicholson and Barclay, 2005

Appendix 3

List of Committees in CAA

TYPE		MEMBERS	POSITION	CONVOCATION
1	**Credit Committee**	1	CEO (Chairman)	at least once per week
		2	Deputy GM/ Head of Enterprises Unit	
		3	COO	
		4	Head of Retail Banking	
		5	Head Risk Management and Permanent Control	
		6	Head of Credit Risk Assessment / Committee Secretary	
		7	Head of Compliance Sector	
1.1	*CIB Committee*	1	Head of Enterprises Unit/Chairman	whenever necessary
		2	D. Head of Enterprises Unit /D.Chairman	
		3	Head of Risk Management and Permanent Control	
		4	Head of Compliance	
		5	Head of Credit Risk Assessment / Committee Secretary	
1.2	*Retail Committee*	1	Head of Retail Banking/Chairperson	at least once per week (not functional)
		2	Head Network Division/D.Chairman	
		3	Head of Credit Risk Assessment officer	
		4	Credit Risk Assesment Specialist / Business Loans responsible - Committee's Secretary	

2	**Internal Control Committee**	1	CEO (Chairman)	at least quarterly
		2	Deputy GM / Head of Enterprises Unit/Deputy Chairman	
		3	Head Internal Audit	
		4	Head Risk Management and Permanent Control	
		5	Head of Compliance Sector	
		6	Head Legal Division	
		7	Head of permanent control & operational risk officer -secretary	
		8	Chief Operations Officer	
		9		
3	**ALCO Committee**	1	CEO(Chairman)	at least monthly
		2	COO (alternate chairman)	
		3	CFO	
		4	Deputy GM/ Head Enterprises Unit	
		5	Head Retail Banking	
		6	Head of Treasury Sector	
		7	Head Risk Management and Permanent Control	
		8	Head of Marketing and Communications Division	
		9	Emporiki Greece, Group Treasurer or his representative	
		10	Emporiki Greece, Group Risk Div. Manager or his representative	

4	**NAP Committee**	1	CEO – Committee Chairman	The frequency of the NAP Committee meetings is set based on the needs of the Business Unit that it serves. Extraordinary meetings are convened the soonest possible after the submission of a relevant request by any permanent member of the Committee, through the Head of the Committee and relevant approval by the Committee Chairman.
		2	8. CIO (or an appointed representative)	
		3	9. Head of Compliance Sector (or an appointed representative)	
		4	10. Head of Legal Division (or an appointed representative)	
		5		
		6		
		7		
5	**Security Committee**	1	CEO/Chairman	at least quarterly and as required
		2	Deputy GM/ Head of Enterprises Unit	
		3	COO	
		4	Head of Retail Unit	
		5	Head of Information Security/BCP Manager	
		6	Head Risk Management and Permanent Control	
		7	Head of IT Division	
		8	Head of Administrative Services Sector	

		9	Head of Internal Audit (Advisor role)	
6	**Purchasing Committee**	1	CEO (Chairman)	when needed
		2	COO-permanent member	
		3	CFO-permanent member	
		4	The Head of the Unit in charge for the expenses of the specific subject	
7	**HR Committee* to be approved during Q1, 2013 by the Board of Directors**	1	CEO (Chairman)	once per month
		2		
		3	Head HR	
8	**Customer Complaints Committee**	1	CEO	Monthly basis
		2	COO	
		3	DGM/Head EU	
		4	Retail Unit Head	
		5	Head of Compliance Sector	
		6	Busines Control&Support of Network, Head	
		7	CFO,HR,Risk,LU in specific case when the presence is necessary	
9	**Audit Committee**	1	Chairman	at least four time per year
		2	in process of aproval by Central Bank	
		3	Head Internal Audit (Secretary)	

10	**Sensitive Affairs and Provisioning Committee**	1	CEO (Chairman)	Quarterly
		2	Deputy GM / Head of Enterprises Unit	
		3	COO	
		4	Head Risk Management and Permanent Control/Deputy Chairman	
		5	Head Legal Division	
		6	CFO	
		7	Head of Recovery	
		8	Head of Retail Unit	
11	**Anti-Fraud Committee**	1	Deputy General Managers	at least quarterly and as required
		2	Head Risk Management and Permanent Control /Deputy chairperson	
		3	Head of Internal Audit	
		4	COO	
		5	Head of Retail Unit	
		6	Head of Marketing & Product Development	
		7	Operational Risk and Permanent Control Officer	
		8	Head HR	
		9	Head Legal Division	
		10	Head of IT Division	
		11	Head of Retail Network Division	

12		12	Head of Compliance Sector	
		13	Committee secretary	
	Assets Management Committee	1	CEO(Chairman)	when needed
		2	COO	
		3	Head Risk Management and Permanent Control	
		4	CFO	
		5	Head Legal Division	
		6		
13	**IS Committee**	1	CEO	at least quarterly and as required
		2	Deputy GM / Head of Enterprises Unit	
		3	CIOO (leader of the committee)	
		4	COO/D Chairman	
		5	Head of Retail Unit	
		6	Head Risk Management and Permanent Control/Deputy Chairman	
		7	CFO	
		8	Information Security Oficcer	
		9	Head of Organization(Secretary of Committee	
		10	Head of IT	
14	**Risk/Accounting Data**	1	Deputy Finance	Monthly basis

	Reconciliation Committee		Division Manager / Chairman	and as required
		2	Head of Permanent Control & Operational Risk Sector/ Member	
		3	Head of Accounting & Tax Sector / Member	
		4	Head of Reporting Sector / Member	
		5	Head of Risk Reporting & Analysis Department - Risk Management Sector / Member	
		6	IT in case specific or other issues/projects will be discussed	